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U.S. Trustee on Lookout for Substantial Abuse

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As members of the bankruptcy bar for the Eastern District of Washington have been discovering, the United States Trustees program has been dedicating considerable resources towards the enforcement of 11 U.S.C. 707(b) of the Bankruptcy Code. The addition of another attorney as well as another part time legal clerk has resulted in renewed enforcement vigor.

In short, if chapter 7 debtors can pay back a substantial portion of their obligations in a chapter 13, it would be a *substantial abuse* to allow their case to proceed to discharge. As set forth in the defining Ninth Circuit case of *In Re Kelly*, 841 F.2d 908 (9th Cir. 1988), the debts at issue have to be primarily (more than one half) consumer debts, not business debts.

In considering what constitutes substantial repayment, the early cases demanded a high percentage of repayment, no matter the size of the debt. More recent cases, however, are looking at the amount of repayment as viewed by the creditors and deciding whether that amount is *substantial* and ignoring whether it repays a certain percentage. *See, e.g. In Re Gomes*, 220 B.R. 84 (9th Cir. BAP 1998); *In Re Coleman*, 231 B. R. 760 (Bkrtcy D. Neb. 1999). It would be inequitable to pursue the grocery store checker who can pay 70% of his low debt load with $300 per month, but ignore the cardiovascular surgeon who could repay $160,000 of his debt, but would amount to only repaying 10 per cent of his 1.6 million dollar debt load or 10 cents on the dollar. (By the way, in the surgeon's case, since the unsecured debt amount exceeds the debt limit of the chapter 13, the United States Trustee would argue that he can repay that amount in a chapter 11.)

This office recognizes that an inquiry letter costs the lawyer and clients time, therefore money, and certainly anxiety and stress for the clients. You can expect to get a letter when one or more of the following circumstances exist in your case:

1. When income listed on Schedule I substantially exceeds the expenses of Schedule J, so that there remains a substantial amount of money to fund a plan. The bill that is presently (if not eternally) before Congress says that $100 more in income than expenses creates a presumption of abuse.
2. On the Statement of Financial Affairs, question 1, the debtors list that they earned considerably more money for the last year or two than the amount projected on Schedule I for the current year.
3. If the debtors list historical or present income of $52,000 for a family of 4, which is the threshold income of the proposed legislation (and incidentally the threshold that the office has historically used), less for a single individual, you are most likely going to get a letter. The smart practitioner seeing present or historical income in

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Inside...

Fees to Increase November 1, 2003

The Judicial Conference of the United States at its September 2003 session, approved changes to the miscellaneous fee schedule for bankruptcy courts promulgated under 28 USC 1930. These increases were approved to account for inflation and rising court costs, and will become effective on November 1, 2003. The entire text of the changes and additional information may be found on the court's website at www.waeb.uscourts.gov.

A brief synopsis of the increases are as follows:

- Certification of documents, from $7 to 9$;
- Reproduction of recordings of proceedings, from $20 to $26;
- Amendments to creditors schedules, from $20 to $26;
- Search of records, from $20 to $26;
- Filing a document not in a case not filed in the court, from $30 to $39;
- Miscellaneous administrative fee, from $30 to $39
- Check returned for lack of funds, from $35 to $45;
- Filing and docketing a notice of appeal, from $105 to $255;
- Retrieval of record from archives, from $35 to $45;
- Dividing a joint case increased from 1/2of the filing fee to the entire filing fee;
- Filing a motion to modify the 362(a) automatic stay, compel abandonment or withdraw the reference, from $75 to $150; and
- Docketing a cross appeal, from $100 to $250.

It should be noted that the increase in the administrative fee by $9, essentially increases the amount required to be paid at filing for all of the various chapters, to wit: Chapter 7 - $209, Chapter 13 - $194; Chapter 11 - $839; and Chapter 12 - $239.

It should also be noted that the schedule regarding relief from the automatic stay provides that no fee is required for a motion for relief from the co-debtor stay or for a stipulation for court approval of an agreement for relief from a stay. LBR 4001-1 provides that a stipulation with the debtor is effective only as to acts against the debtor or debtor's property, however, for an order based on such a stipulation, no fee would be due. A party may also combine a motion for relief from the automatic stay with a motion to compel the trustee to abandon property of the estate and pay a single fee.

Substantial Abuse (cont'd)

these ranges should obtain and review their clients' earning statements and tax returns (along with W-2 statements) for the past two years in order to determine whether a chapter 13 or a chapter 7 is appropriate.[1]

4. The schedules are incomplete. For example, very often the debtors list the same amount for gross *and* net income. That cannot be if they are employed outside their own business.

5. The schedules disclose an intent to keep and pay for "toys", *e.g.* recreational vehicles, travel trailers/campers, boats and trailers, condominiums, snowmobiles, jet skis, dune buggies, horses, etc. The schedules may also list payments for *luxury* vehicles.

6. The schedules exhibit aggressive and inappropriate pre-bankruptcy planning. For example, in a rather recent case, a husband and wife each purchased new sport utility vehicles within the two months prior to filing a bankruptcy. The total cost was close to $75,000. They did not contest the motion of the United States Trustee to dismiss.

7. The schedules show high mortgage payments. If such evidence a home of unusually high value, is it right that the creditors bear the sacrifice of letting them continue to live in the home without moving down to a more reasonably priced home? On the other hand, if the high mortgage payments have ended up on a home of reasonable value (the dreaded 125% second mortgage having locked its talons into the home), is it reasonable for the creditors to bear the continued cost, or should the debtors let the place go back to the secured creditor and look for other reasonably priced housing?

Other factors may stimulate inquiries, but they are usually in conjunction with one or more of the above factors. You may wish to preempt an inquiry letter by noting in the schedules pertinent facts — such as one person losing his or her job on such date — and the fact that unemployment insurance payments will run out on such date. Health issues always deserve communication.

The United States Trustee always expects local counsel to fully and competently represent their clients and therefore, in a close case, a challenge to the United States Trustee is appropriate. We expect it and respect it. On the other hand, the United States Trustee does not welcome a close case being filed without you, the attorney, having fully thought it through. Too often the United States Trustee encounters debtors who are obvious candidates for dismissal under 707(b). These debtors frequently claim that their bankruptcy attorneys did not discuss with them the implications of substantial abuse. Shortly after a letter from the United States Trustee arrives, their attorney withdraws or asks for an additional fee for converting the case to a chapter 13 or disputing the motion to dismiss. The Office of the United States Trustee believes that the bankruptcy system and debtor clients are not well served by attorneys who do not plan for the possibility of a motion under section 707(b).

[1] The US Trustee's experience, in reviewing cases for over 14 years, is that debtors typically under-report income. During that time, only *once* has a debtor over-reported his income in a Schedule I. Rarely, over those same years, have the debtors reported the *accurate* income. The rest have under-reported their income. The logical inference is that the large majority of attorneys are not reviewing their clients' earning statements and tax returns before signing the schedules.

From the Office of the U.S. Trustee

Complete and Accurate Bankruptcy Schedules

By Jake Miller, Assistant U.S. Trustee

The office of the United States Trustee has begun reviewing bankruptcy schedules and statements with an eye to increasing the standard of quality expected in this district. We hope that debtor's attorneys will advise clients that all questions must be answered accurately and completely. We anticipate bringing enforcement actions when the initial bankruptcy paperwork does not meet minimum standards.

Items which commonly call into question the completeness and accuracy of the debtor's paperwork are:

Schedule A - Description and location of real property omitted. "Home" is not sufficient. The complete address should be included. Nature of debtor's interest omitted. "Unsecured portion" omitted or incorrectly calculated. Real property listed on Schedule A does not reconcile with secured debts listed on Schedule D.

Schedule B – "None" not checked, yet nothing else listed. Nothing at all listed under "firearms, sports, photographic, or other hobby equipment." And it is possible, but not likely, that debtors living in a $380,000 home have only $600 in household goods and furnishings, including audio, video and computer equipment.

Schedule D - No date the claim was incurred. Nature of lien, description or value of collateral not listed. Secured debt listed on Schedule D does not reconcile with property listed on Schedules A and B.

Schedule E - Priority claims are listed that are not entitled to priority.

Schedule F - No date the claim was incurred. Consideration for the claim omitted. "Insufficient funds," "Credit card," "Revolving account," and "Collection" are not consideration for a claim. Account numbers omitted. Creditors' addresses omitted.

Schedule I - Heading information - names, occupation, employer - omitted. Gross income and itemized payroll deductions not detailed. "Gross income" and "Net income" are the same figure. Detailed statement of business income not provided. From years of examining debtors' wage statements, the United States Trustee has regularly found Schedule I income to be understated. It is probably not in the debtor's best interests to begin a 707(b) hearing by explaining to the court why the debtor's income is understated on the bankruptcy schedules.

Schedule J - Detailed statement of business expenses not provided. Schedule J expenses considerably exceed Schedule I income. Some debtors apparently believe that the schedule of expenses is a listing of what the debtors need, rather than what they actually spend. Again, it is in a debtor's best interest to be accurate.

Debtors' attorneys should pay increased attention to the accuracy and completeness of the initial bankruptcy paperwork.

Help Clients Avoid Losing Their Homes

See "Predatory Lending," Page 8

Some of the most common techniques used to strip homeowners of their equity and their homes are:

- Kickbacks to mortgage brokers (Yield Spread Premiums, where a broker can get a loan at a lower interest rate, but tells the borrowers only about the higher rate loan so that the broker will receive a kickback from the lender);
- Payments the borrower cannot afford;
- Falsifying loan applications (i.e., income);
- Adding insincere co-signers;
- Making loans to mentally incapacitated homeowners;
- Forging signatures;
- Paying off lower income or interest mortgages;
- Loans in excess of 100% LTV;
- Changing loan terms at closing;
- High annual interest rates;
- High points or padded closing costs;
- High loan origination fees;
- Balloon payments;
- Negative amortization;
- Inflated appraisal costs;
- Padded recording fees;
- Bogus broker fees;
- Itemizing duplicate services and charging separately for them;
- Required credit insurance and/or inflated price, single premium insurance;
- Mandatory arbitration clauses;
- Falsely identifying loans as lines of credit or open ended mortgages;
- Forced placed homeowners insurance;
- Repeated refinancing (flipping);
- Daily interest when payments are late;
- Excessive prepayment penalties;
- Foreclosure abuses; and
- Home improvement scams.

From the Clerk

Statistics

Projected filings for 2003 are approximately11,000 cases, which will be an increase of about 5% over 2002. The increases are largely in chapter 7 cases, which account for 75.7% of all cases filed, followed by chapter 13s at 23.5% and Chapter 11s and 12s that together account for only .8%. The court maintains considerable statistical data on its data base, which is available from the court=s website at www.waeb.uscourts.gov

Disclosure of Social Security Numbers

Anticipated changes to the Federal Rules of Bankruptcy Procedure as well as to the Official Bankruptcy Forms, expected to become effective December 1, 2003, will implement Judicial Conference policy that states that documents filed in bankruptcy cases should be available electronically, but that only the last four digits of the debtor's Social Security number should be displayed. The debtor's full Social Security number will be required to be disclosed by a separate verified statement that will be *submitted but not filed.* Only the last four digits will be required on *filed* documents, such as the petition itself. The notice of meeting of creditors, sent to all parties in interest in a case will, however, include the debtor's full Social Security number. The party filing documents in a bankruptcy case is responsible for redacting Social Security numbers. What is presented for filing is filed and made available electronically by the clerk. The above noted verified statement, since it is submitted and not filed, is not generally made available electronically, except to parties in interest in the notice of a 341 meeting.

Electronic Filing Is Coming!

The court is a part of a national automation initiative called CM/ECF (Case Management/Electronic Case Filing). This action is necessitated by the need to replace the court's outdated case management system, a DOS-based system called NIBS that has been in use since 1986, and allows the court to take advantage of ECF, the judiciary wide electronic case filing system.

The conversion from NIBS to CM is expected to be completed in early 2004. Once that task is accomplished, then documents will be able to be filed electronically using ECF. In order to successfully file documents electronically, the filing party will need to obtain a certain level of skill and knowledge. The court will offer a variety of training opportunities to prospective users. Detailed information concerning ECF is available on the court's website at www.waeb.uscourts.gov.

RACER to be Replaced by PACER

RACER, the court's electronic access program, is scheduled to be replaced by PACER, a nationally supported electronic public access system. RACER is unable to accommodate the upcoming Judicial Conference policy on privacy and public access to electronic court files which are due to become effective December 1, 2003. Several national rules as well as official forms are expected to take effect on that day which limit the use of Social Security numbers to the last four digits as well as certain other selected items of information. Additionally, RACER is not compatible with CM, which is scheduled to replace the court's current operating system in early 2004.

Some years ago, the Judicial Conference of the United States, under the authority of 28 USC 1930(b) prescribed certain fees for electronic access with the proceeds from those fees to be deposited in the Judiciary Automation Fund, which is used to support and develop electronic access to court information. This court was unable to assess a charge for access to RACER because a billing module was not available. PACER, however, does have a billing module and therefore once the move is made from RACER to PACER, the fees prescribed by the judicial conference will need to be paid.

Ex Parte Orders Based on Stipulations

Webster's Dictionary defines a stipulation as an agreement between attorneys respecting the conduct of legal proceedings, and notes that stipulations generally fall into one of two categories; first, those related to procedural matters and second, those which have all the characteristics of a mutual contract. In a bankruptcy context, some stipulations are strictly between or among selected parties, some affect the estate or creditors, and some require a court order.

An occurrence that seems to be happening more frequently is the presentation of an order based on a stipulation, or an order that contains a stipulation between disputing parties, some of which fall within the first category, some within the second category, and some within both categories.

Parties are free to stipulate between themselves as a method of resolving their differences, and are also free to file any such stipulation in a case or adversary proceeding. However, where the parties desire or are required to obtain an order, the court has certain concerns in addition to ensuring that the provisions of LBR 2002-1 are satisfied.

LBR 2002-1(e) provides that the moving party may present a proposed order by submitting the proposed order to the Clerk and by filing a motion or application and an affidavit or statement under penalty of perjury, that no objections are pending. The certificate of no pending objections is not required if all of the parties to whom notice was required to be sent, have signed off on the order. If all parties who were entitled to notice have not signed off on a stipulation, the certificate of no pending objections is required.

Judicial Guidelines Concerning Stipulated Orders

Procedural concerns aside, the judges have provided the following guidelines for situations where the parties to a stipulation wish to have the stipulation be the subject of a court order:

Parties wishing an order approving a stipulation must present a separate order through the usual ex parte process. Any such order ought not to recite all provisions of the stipulation, but merely identify the stipulation and that it is approved[1]; and

If the stipulation contains a request for judicial action, the order should grant or deny the relief consistent with the stipulation, but not recite the provisions of the stipulation; and

Stipulations that contain provisions which state that in the event of a default of a term or terms of the stipulation, the relief sought will be automatically granted, such as a lift of the automatic stay or dismissal of the case will not be approved[2]; and

Stipulations should contain a provision that after default, a separate ex parte order is required to be presented, supported by a certificate of non-compliance with the terms of the stipulation specifically setting forth the default as well as the giving of any notice, if required by the stipulation itself.

[1]Editors Note: It would probably be a good idea to attach a copy of the Stipulation as an Exhibit to the order being submitted.

[2]Editors Note: Meaning that such a stipulation will not be entered ex parte, but must first be noticed out to creditors and interested parties.

New Co-Debtor Rule

In both Chapter 12 and 13 cases, stay protection is afforded to a co-debtor. The rule recently adopted as LBR 4001-3 sets out the process required for the stay to be lifted. The co-debtor stay is a separate provision and is not related to the automatic stay provided by 11 USC 362. It should be noted that a motion to lift the co-debtor stay is not to be combined with a motion for relief from the automatic stay pursuant to LBR 4001-1. A copy of the rule is able to be viewed and downloaded over the court's website at www.waeb.uscourts.gov.

Changes to Local Rules on Chapter 13

The court recently approved changes to portions of two local rules concerning Chapter 13 matters. The first, LBR 2083(l)(6) requires that a prescribed local form, LF 2083D be used by the debtor when seeking an order allowing the trustee to make pre-confirmation adequate protection distributions. The second, LBR 2016-1 clarifies that when a flat fee is selected by the debtor's attorney in a Chapter 13 case, any filing fees may be collected from the debtor in addition to the flat fee, however, all other costs are included in the flat fee. Complete text of these rules are available on the court's website at www.waeb.uscourts.gov.

History of the Bankruptcy Court

As a project of the Eastern District of Washington Historical Society, Ted McGregor and Bonnie Charney have been tasked with putting together a history of bankruptcy in the Eastern District of Washington. The project has been divided into a number of sections that are able to be accomplished independently of one other. The categories include: The Earliest Years - Constitution to the Act of 1898; The Early Years - 1898 to 1978; The Present - 1978 to the present; Referees and Judges; Cases of Interest; Lawyers of Note; the Bankruptcy Bar Association; The Office of the Clerk and Administration of the Court; and Bankruptcy Trustees.

Any input from bankruptcy practitioners who have any information or memorabilia concerning any of these topics, or who would like to assist in the project are invited to contact Ted McGregor.

Reopening Cases

The court is seeing an increase in the number of requests to reopen cases. The principal reason for requests to reopen is for lien avoidance, generally judicial, pursuant to 11 USC 522(f). LBR 5010-1 provides the process for reopening a case. Once a case is reopened then the desired action may be taken. For instance, if the purpose was to avoid a 522(f) lien, then LBR 4003-1 should be consulted for that procedure. The only item that may be combined with a motion to reopen is a motion for the appointment of a trustee. Unless the purpose of the reopening is to correct an administrative error or for an action related to the debtor's discharge, a fee equal to the fee for filing a case under the same chapter is required, $155 for Chapters 7 and 13, $800 for Chapter 11 and $200 for a Chapter 12 is required by 28 USC 1930.

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From the Clerk cont'd

Service in Contested Matters

Proper service in contested matters continues to be a frequent reason why proposed orders are required to be returned, particularly for objections to proofs of claim and avoidance of liens pursuant to 11 USC 522(f). Contested matters are governed by FRBP 9014, and initial service is to be made as required by FRBP 7004, which is the same rule that applies to service of initial process in adversary proceedings. Therefore, the party initiating a notice should first determine whether or not the matter is a contested matter. If it is determined that the matter is a contested matter, then service of the notice is governed by FRBP 9014. When a proposed ex parte order in a contested matter is presented following notice and hearing where no objections have been filed, as is permitted by LBR 2002-1(e), the underlying procedural aspects are reviewed, and if service was not properly affected, the order is most often returned unsigned. The standard used in determining whether or not service was proper in contested matters is the same as is used for entry of defaults in Adversary Proceedings.

Notices Must Set Forth Times to Object

When giving notice and hearing pursuant to LBR 2002-1, which is the principal manner in which almost all events are set into play in bankruptcy, a review of that local rule is recommended. One item is the time a recipient of such a notice has in which to file an objection to the entry of an order or an action being taken. The normal time is 20 days, but for certain selected actions the time can be more or less. If the notice is provided by mail, then there needs to be three days added to the time pursuant to FRBP 9006.

Failure to give the proper time, or any time at all, to file an objection, is a fairly common reason why proposed ex parte orders are unable to be signed, and are returned.

Certificates of Mailing of Notices

LBR 2002-1(b)(3) requires that a party giving a notice is required to file as a separate document an affidavit or unsworn declaration under penalty of perjury, and that a list containing the names and addresses to whom the notice was sent as well as a copy of the notice sent be attached. In providing a procedural review of ex parte orders submitted pursuant to LBR 2002-1(e), it is most helpful if the certificate of mailing, required by LBR 2002-1(b)(3) is complied with. Failure to follow this rule and others can result in a delay in the processing of the proposed orders or a requirement that the order be returned unsigned.

Re-Conversion of Case by Debtor

11 USC 1307(a) permits the debtor in a Chapter 13 case to convert the case to one under Chapter 7 at any time, and FRBP 1017 provides that the conversion is accomplished by notice without need for a court order. Bankruptcy Code section 707(a) allows a debtor in a Chapter 7 case to convert the case to any other chapter, although an order is required by FRBP 1017. However, the right to convert a case from Chapter 7 to a Chapter 11, 12 or 13 case by the debtor is allowed only if the case has not been previously converted pursuant to 1112, 1208 or 1307.

Certification of Date on MML

LBR 2002-1(d) provides that a notice required to be given to all creditors is deemed to be appropriate if mailed to all entities on a Master Mailing List or Limited Mailing List prepared by the office of the clerk within twenty (20) days of the notice. FRBP 2002(g) sets out the requirements for the addressing of notices required to be sent under Rule 2002. MMLs for all cases in the court's data base are updated each night by a program designed for that purpose so they satisfy the requirements of FRBP 2002(g).

MMLs are easily obtainable from the court's website at www.waeb.uscourts.gov, in three different formats; labels, an import file and a browser. If the labels are used, the date the MML was retrieved from the court is noted as a part of the first label, if the other two formats are used, the date is not noted. Therefore, if the format selected does not contain the date retrieved, the party using the list would need to provide that information separately. It is suggested that it could be included as a part of the Certificate of Mailing of Notice required by LBR 2002-1(b)(3).

Unclaimed Funds

Code section 347(a) requires the trustee 90 days after the final distribution in chapters 7, 12 and 13 to stop payment on any checks remaining unpaid, and pay any remaining funds to the clerk. FRBP 3011 requires the trustee to file with the payment of the funds to the court, a list of all known names and addresses of persons entitled to the funds, as well as amounts of monies so paid. These funds, known as "unclaimed funds," may be claimed by the named party by request to the court. The court has on its website at www.waeb.uscourts.gov a section entitled "Unclaimed Funds" which anyone may visit to ascertain if they are due such unclaimed funds. Also on the website are directions and forms required to properly claim the funds. Since this information was made available to the public, the court has paid to claimants unclaimed funds of over $13,000.

Discharges

Discharges are routinely granted in Chapter 7, 12, and 13 cases. In Chapter 11 cases, discharges are included in the order of confirmation pursuant to11 USC 1141.

In Chapter 12 and 13 cases the discharge is granted when the trustee certifies to the court that the debtor has completed the plan. The debtor may be granted a so called "hardship" discharge even though the debtor has not completed the plan payments if the court determines that the failure to complete the plan was not the debtor's fault, the unsecured creditors received as much as they would have in a Chapter 7 liquidation, and that modification of the plan is not practicable.

In order to receive a hardship discharge, the debtor must send notice to the master mailing list in accordance with LBR 2002-1, setting out the reasons for the request and providing twenty days for parties to object, plus any additional time allowed by FRBP 9006. If there are no objections, then an order may be submitted to the court for consideration in accordance with LBR 2002-1(e).

Additionally, FRBP 4007(d) requires that upon the filing of a motion for a hardship discharge in a Chapter 13 case, the court is required to fix the time to file a complaint to determine the dischargability of any debt under 11 USC 523(c) and give creditors no less than 30 days notice of the time so fixed.

As required by FRBP 4004(c), unless a complaint has been filed, chapter 7 discharges are granted as soon as the time to object to the granting of the discharge has expired, along with the time set for filing motions to dismiss pursuant to11 USC 707(b) (substantial abuse). Additionally, the failure to pay the filing fee and any other fees payable upon commencement of a case will hold up the entry of the discharge. Under FRBP 4004(c)(2) the debtor may file a motion to defer the entry of the order granting the discharge.

It should be noted that a motion to defer entry of the discharge does not extend the time to file a complaint to object to the discharge or to determine the dischargability of a debt. A debtor may wish to defer entry of the discharge so that a reaffirmation agreement as noted at 11 USC 524(c)(1) is able to be made before the granting of the discharge, as is required.

In that same vein, if the basis of the reaffirmation agreement is related to dischargability issues and if the debtor's right to rescind a reaffirmation agreement would extend beyond the time set to file a complaint to determine the dischargability of any debt under 11 USC 523(c), the creditor may wish to file a motion to extend that time. The filing of this kind of motion pursuant to FRBP 4007 will not delay the granting of the discharge.

An order deferring the entry of the discharge may be presented by the debtor on an ex parte motion, however, an order to extend the time in which to file a complaint objecting to the granting of a discharge or to determine the dischargability of any debt is done after 20 days notice and hearing to the debtor and debtor's attorney.

Notice of Proposed Local Rule Change

On the recommendation of the Court's Standing Advisory Committee, the Judges of the Bankruptcy Court have approved the adoption of a change to LBR 2083-1, the general rule concerning Chapter 13 cases. The proposed change to the rule is to add the following language to sub-section (l)(6) that concerns pre-confirmation adequate protection payments: "Within ten (10) days of entry, the debtor shall provide a copy of the order to the creditor receiving the payment addressed as required by FRBP 2002(g)." The entire rule is able to be viewed over the court's website at www.waeb.uscourts.gov. The purpose of this notice is to provide opportunity for public comment. The comment period ends December 5, 2003. Comments should be in writing and sent to Clerk of Court, U.S. Bankruptcy Court, Eastern District of Washington, P.O. Box 2164, Spokane WA 99210.

Changes to Attorney Rule

Sub-section (3) has been added to section (a) of LBR 9010-1. This change sets forth six circumstances for which an attorney may represent a client before the court without first being admitted to practice before the court. Those circumstances are :

(1) Requesting special notice pursuant to FRBP 2002 or to be added to a MML pursuant to LBR 2002-1(d);

(2) Seeking compensation pursuant to 11 USC 330 when employed pursuant to 11 USC 327 in a matter where admission was not required;

(3) Filing a proof of claim;

(4) Signing or filing a reaffirmation agreement pursuant to 11 USC 524;

(5) Participating in a Meeting of Creditors held pursuant to 11 USC 341; and

(6) Representing a child support creditor so long as the appropriate form is filed.

Welcome to the World of Predatory Lending

By Melissa Huelsman[1]

As housing prices have steadily risen during the last several years, many homeowners are tempted to use their home equity to solve their economic problems.

Lenders, ready and willing to extend credit fill homeowners' mailboxes with solicitations, without regard to whether the borrower may be unemployed, incapacitated, without equity in their homes, or simply unable to repay the loan. Welcome to the world of predatory lending.

Predatory lending has been defined as, "an unsuitable loan designed to exploit vulnerable or unsophisticated borrowers."[2] Predatory loans are a type of sub-prime loan, made to borrowers with less than perfect credit. Sub-prime lenders legitimately charge a higher interest rate in order to compensate for added risk. But predatory loans have one or more of the following additional features: 1) higher interest and fees than necessary to cover the added risk; 2) abusive terms and conditions that lead to increased indebtedness; 3) loan amounts in excess of the borrower's ability to pay; 4) violation of fair lending laws by targeting the elderly, the infirm or incapacitated, women, minorities, communities of color, or anyone who is financially unsophisticated.

Predatory lending victims can end up with payments that exceed their ability to pay, and sometimes even their income. Thus, they find themselves seeking out bankruptcy assistance to obtain relief from the excessive payments and/or to bide time to sell their homes before they lose it to foreclosure. While bankruptcy attorneys will typically place the victims in a Chapter 13 bankruptcy without further consideration, bankruptcy practitioners that do so are potentially committing malpractice if they do not at least review the debtor's loan documents to attempt to ascertain whether or not the debtor is a predatory lending victim.

A fairly cursory review of the documents will often be sufficient to make an initial determination regarding the reasonableness of the loan. Loan origination and/or mortgage broker fees that exceed more than 2% of the loan amount should raise suspicion. Any other "junk" fees, such as loan application, processing, document preparation fees, or yield spread premium fees paid to a mortgage broker by the lender outside of closing should also be closely scrutinized. Excessive interest rates on first mortgage loans, and long term pre-payment penalties may also be used by predatory lenders to strip equity from the home.[3]

Another predatory practice is the inclusion of multiple and expensive single premium insurance policies, issued by an insurance company that is affiliated with the lender, in the loan amount. Such practices result in substantial additional interest paid over the life of the loan. For instance, a single premium credit life insurance policy providing ten years of coverage during the first ten years of a loan (which pays off the lender in the event of the death of the borrower) costs $10,000. When the additional $10,000.00 premium is included in a 25-year loan at 11.96% interest, the total cost to the borrower will be $39,900 when paid over the life of the loan. Any attorney reviewing a loan file for a client should be looking for the inclusion of unwanted and unrequested credit life and/or disability insurance.

Additionally, when counsel suspects a predatory loan the attorney should request a payment history from the lender in order to determine whether the lender has added significant and unjustified charges during the life of the loan. Late charges that the client can disprove are quite common, as well as excessive "property drive by" charges and other miscellaneous, unsupported charges. There is an emerging movement against loan servicing companies that are engaged in overcharging. Bankruptcy practitioners should object to any claim filed by a loan servicer who appears in a case without standing to appear on behalf of the purported assignee and/or lender. Counsel should also check for inaccuracies in escrow accounts for insurance and/or property taxes.

Attorneys should also interview their clients regarding the circumstances surrounding the obtaining of the loan and if the loan application is included in the packet, look for any significant alterations in the income of the clients, as lenders and mortgage brokers will sometimes falsify a borrower's income unbeknownst to the borrower. The clients should provide information regarding the documentation, if any, that they received from the borrower and/or mortgage broker prior to the loan signing because failures to disclose the true amounts and terms of the loan are some of the most common predatory lending techniques.

There are numerous relevant statutes that counsel should review prior to deciding whether to pursue a predatory lending case. Among the most important to consider are: the Truth in Lending Act, Real Estate Settlement Procedures Act, Washington Mortgage Broker Practices Act, Washington Consumer Protection Act, Washington Consumer Loan Act, relevant insurance regulations, and common law claims for fraud, unjust enrichment, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty (usually against mortgage brokers).

If the bankruptcy attorney believes that a predatory lending claim exists, it can be pursued through an objection to the proof of claim filed by the lender, servicer or assignee or through an adversary action. Often, prosecution of a debtor's predatory lending claim may be the debtor's only means of preserving any equity in the home.

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[1] Ms Huelsman is a member of the KCBA Volunteer Legal Services, and is also a member and Chairperson of the Seattle-King County Coalition for Responsible Lending. She practices in the areas of predatory lending and fraud litigation and investigation, and in bankruptcy.

[2] National Community Reinvestment Coalition

[3] There is a list of specific predatory lending practices listed at the end of this article.

Case Notes

Excerpts from Case Law Updates Presented at Sun Mountain

"NOTES" thanks the Hon. Frank L. Kurtz and Mary Ellen Gaffney-Brown for the use of their materials

Liens

A.A.R. Testing Laboratory, Inc. v. New Hope Baptist Church, 112 Wn. App. 442, 50 P.3d 650 (2002).

Facts:

(1) After a church fire, New Hope hired Heritage Construction to construct a church.

(2) Heritage commenced construction on February 20, 1997.

(3) Each time Heritage was paid, it signed a waiver and release, whereby it released any lien claim as to work for which it was paid.

(4) New Hope obtained construction financing after the construction was started. Herring National Bank received a first deed of trust filed December 4, 1997. Herring demanded that Heritage release all lien claims but it did not obtain a subordination agreement.

(5) American Church Mortgage provided additional financing and it received a second deed of trust filed June 24, 1998.

(6) After both deeds were filed, Heritage signed its last of six waiver and release agreements to receive a payment on June 30, 1998.

(7) At the end of the project, Heritage claimed it was owed approximately $700,000.

(8) A lawsuit was started by a subcontractor and resulted in litigation to determine priorities.

Issue: What is the priority date for Heritage's lien for unpaid work; February 20, 1997 (for work commenced) or June 30, 1998 (the date on which it released its lien)?

A. A mechanic's or materialmen's lien is authorized by RCW 60.04.021 and arises and attaches upon the performing of labor or furnishing of material.

B. Such a lien is an exception to the general rule of first in time.

C. But the priority of the lien may be changed by a voluntary agreement.

D. Heritage argued that the release of its lien for work completed did not extinguish its inchoate lien for future work that related back to the date of filing.

Holding: A waiver and release of lien for completed work does not extinguish the lien or change the priority for work commenced thereafter. For that result, a subordination agreement is required.

Better Fin. Solutions, Inc. v. Transtech Elec., Inc., 112 Wn. App. 697, 51 P.3d 108 (2002).

Facts:

(1) Transtech is the general contractor on a public works contract for a school district.

(2) Breland Enterprises is a cement subcontractor.

(3) Better Financial Solutions (BFS) contracted with Breland to provide temporary labor for the project.

(4) Actually, all of BFS's temporary employees were old Breland employees—the scheme was a financing arrangement whereby Breland used and supervised the employees on the jobsite and BFS paid them.

(5) At the end of the project, Breland owed BFS $84,411 and BFS filed a claim against Breland's retainage and bond.

Issue: Is BFS eligible to make a claim against Breland's bond?

A. Lien statutes are in derogation of common law and therefore are strictly construed.

B. However, once a party comes within the statute's terms, the statute should be liberally construed to provide relief.

C. RCW 39.08.010 protects laborers, mechanics, subcontractors, materialmen, and others, but specifically excludes financiers.

D. BFS argued that it was a supplier of labor but, unfortunately, the statute does not protect this category, only laborers.

Issue: Is BFS entitled to make a claim against Breland's retainage?

A. RCW 60.28.011 protects persons who are defined at RCW 60.28.011(2) and BFS does not meet the statute's definition of a person. The retainage statute protects the same general categories included in the bond statute and BFS does not fall within any category.

Holding: BFS may not make a claim against either Breland's retainage or bond.

Geo Exch. Sys., LLC v. Cam, ___ Wn. App. ___, 65 P.3d 11 (2003).

Facts:

(1) Pirfil and Elena Cam began construction of North Bonneville Hot Springs Resort.

(2) The Cams hired TECI to install a geothermal heating system.

(3) On December 26, 1997, TECI filed a $998,500 lien against the Cams' property. The lien claim indicated TECI was continuing to work on the project.

(4) TECI did not foreclose upon its lien.

(5) Two years later, on December 18, 2000, TECI filed a second lien for $1,527,163.54, which sum included the still unpaid $998,500.

(6) One year later, the Cams moved under RCW 60.04.081 for an order to remove the liens from their property—the first lien was barred by the statute of limitations and the second lien was clearly excessive because the lien amount included the amount due on the first lien.

Continued on Next Page

Case Notes *cont'd*

Issue: Whether a claimant's right to file successive liens under RCW 60.04.021 is extinguished if: (1) the claimant does not file an action to foreclose on a previously-filed lien within the 8 months under RCW 60.04.141, and (2) the initial 8-month period expires before the claimant completes work on the project.

A. Washington interprets lien statutes liberally.

B. In *Lindley v. McGlauflin*, 58 Wash. 636, 109 P. 118 (1910), the court held:

(1) a claimant can file a new or amended lien within the 90-day period following completion of the work, and (2) the 8-month period for bringing an action to foreclose does not begin to run until the new or amended claim is filed.

Holding: Under the plain language of RCW 60.04.021 and RCW 60.04.091, as long as the claimant is still working on the project, a claimant may file a lien.

N.B.: This rule does not hold for public works projects. *See Airefco, Inc. v. Yelm Comty. Sch. No. 2*, 52 Wn. App. 230, 758 P.2d 996 (1988).

Intermountain Elec., Inc. v. G-A-T Bros. Constr., Inc., 115 Wn. App. 384, 62 P.3d 548 (2003).

Facts:

(1) Ameracare develops retirement communities. Ameracare hired G-A-T to build a retirement center.

(2) G-A-T hired Intermountain Electric to do electrical work.

(3) In 1997, Coghlan and Old Standard provided financing for the project. These two creditors hold a number of deeds of trust with priority from 1997.

(4) Intermountain started work in November 1996.

(5) In July 1999, Ameracare instructed Intermountain to suspend work. Intermountain continued to do some work for a time, ceasing active work on June 6, 2000. Anticipating that the project would restart, it left a trailer on the property, thinking that the project would restart.

(6) Intermountain also filed a materialmen's lien on September 8, 2000, 94 days after it ceased active work. The notice stated that Intermountain was continuing to perform work.

(7) Intermountain sued and sought to establish the priority of its lien over Coghlan and Old Standard.

(8) Coghlan moved for an order under the frivolous lien statute.

(9) The trial court ruled that the lien was invalid and, therefore, frivolous. The court consequently awarded attorney fees and costs under the frivolous lien statute, RCW 60.04.081(4).

Issue: Was Intermountain's lien timely filed?

A. The 90-day filing period is strictly enforced.

B. The lien was filed 94 days after Intermountain ceased work.

C. Intermountain argued that the court should apply an "abandonment rule," *i.e.*, the period runs when the owner abandons the project.

Holding: Washington does not follow the abandonment rule. Intermountain's lien was not filed within 90 days from the completion of work for which payment is due and it is therefore invalid.

Issue: Was the lien frivolous under RCW 60.04.081(4)?

A. To be frivolous, the lien must be filed "beyond legitimate dispute."

B. Not every invalid lien is frivolous.

C. Both the presence of the trailer* and the issue regarding abandonment represent good faith contentions.

Holding: The lien was not frivolous and Intermountain is entitled to its attorney fees for defending the frivolous lien claim.

*The court rejected Intermountain's contention that the presence of its trailer on the project represented a continuation of work or the supply of materials.

Puget Sound Fin., LLC v. Unisearch, Inc., 146 Wn.2d 428, 47 P.3d 940 (2002).

Facts:

(1) Puget Sound Financial (Factors) lends against receivables.

(2) Factors telephoned Unisearch and hired Unisearch to perform a lien search on "The Benefit Group, Inc."

(3) Unisearch performed the service and informed Factors that there no liens.

(4) Unisearch billed Factors $25 for its services on an invoice that stated Unisearch was not liable for consequential damages and that its liability was limited to the fee it charged, $25.

(5) This was the 47th time Unisearch had sent Factors such an invoice.

(6) Factors lent $100,000 to "The Benefit<u>s</u> Group, Inc." Yes, Factors had supplied an incorrect name to Unisearch.

(7) After Benefits defaulted, Factors discovered its lien was junior to the lien of another lender.

(8) Factors sued Unisearch for consequential damages.

Issue: Is the invoice's limitation on liability part of the contract?

A. Unisearch argued that course of dealing between the parties established the liability limitation clause as part of the contract.

B. Factors argued that it had agreed to the oral contract between the parties but that it had never agreed to the provisions of the invoice.

C. Trade usage and course of dealing are relevant to interpreting and determining contract terms.

D. Ambiguity is not required before such evidence may be considered.

E. Here, Unisearch established both that the clause was commonly accepted in the industry and, because it was included in the numerous dealing between Factors and Unisearch, the clause was a common basis of understanding between them.

Issue: Is the liability limitation clause unconscionable?

A. In consumer transactions, a warranty disclaimer must be explicitly negotiated and set forth with particularity. The presumption leans against the disclaimer and the burden is upon its advocate.

B. In commercial transactions, the Berg[1] analysis is modified—the burden is placed upon the party urging the court to invalidate the disclaimer, and negotiations and conspicuousness are only factors to be considered by the court, which looks at "all the surrounding circumstances." Schroeder v. Fageol Motors, Inc., 86 Wn.2d 256, 260, 544 P.2d 20 (1975). Finally, the court looked for evidence of "unfair surprise."

C. Here, there is no evidence of unfair surprise and, looking at the totality of the circumstances, the clause is not unconscionable.

Holding: The clause limits Unisearch's liability to $25.

BNC Mort., Inc. v. Tax Pros, Inc., 111 Wn. App. 238, 46 P.3d 812 (2002).

Facts:

(1) Floyd and Margaret Scott owned and operated a corporation called Mobile Truss, Inc. which borrowed money from Tax Pros. The Scotts personally guaranteed the debt.

(2) After Mobile defaulted, Tax Pros sued. The parties stipulated to a prejudgment writ of attachment, RCW 6.25.020.

(3) Tax Pros moved for summary judgment and received a partial final judgment, CR 54(b).

(4) The Scotts obtained a loan from Ford Consumer Finance Corporation, secured by a deed of trust on their home. The loan proceeds were used to pay a substantial part of the Tax Pros' judgment.

(5) The parties signed a subordination agreement whereby Tax Pros subordinated its judgment lien to Ford, and further agreed not to pursue its remaining claims against the Scotts, provided the Scotts made timely payments.

(6) The Scotts immediately defaulted.

(7) BNC loaned money to the Scotts; the proceeds were used to pay the Ford debt and Tax Pros' judgment. The BNC loan was secured by the Scotts' residence.

(8) Tax Pros then continued its lawsuit and received a judgment for $136,871.

(9) In the interim, the Scotts filed a bankruptcy.

(10) BNC filed a declaratory action, asserting that its deed of trust was superior to Tax Pros' judgment.

Issue: Is BNC's deed of trust superior to Tax Pros' judgment?

A. BNC argued that the lien of Tax Pros' second judgment did not relate back because the prejudgment writ of attachment merged into the first judgment and was, therefore, exhausted.

B. The lien first in time is the first in right. RCW 61.24.020.

C. A judgment lien relates back to the date upon which the real estate was attached.

D. To accept BNC's argument would require judgment creditors to choose between CR 54(b) and chapter 6.25 RCW (the attachment statute).

Holding: Tax Pros' judgment has priority over BNC's deeds of trust.

Holding: By failure to obtain a preliminary injunction or other order restraining the trustee's sale, Mr. Plein waived any objections to the foreclosure proceeding.

Bankruptcy

American States Ins. Co. v. Symes of Silverdale, Inc., 111 Wn. App. 477, 45 P.3d 610 (2002).

Facts:

(1) Symes, a family restaurant and sports bar, filed a chapter 11 petition.

(2) The DIP renewed its fire insurance and increased its limits.

(3) There was a fire.

(4) Thomas Lepre, Symes' president, made a claim for fire damage, which American States Insurance rejected. The insurance company filed a declaratory action, alleging Mr. Lepre set fire to the restaurant.

(5) The case was converted to chapter 7. The chapter 7 trustee pursues the claim. She argues the case is controlled by federal law and, under federal law, the fire insurance policy is property of the bankruptcy estate and the bankruptcy estate is not bound by the unauthorized acts of the debtor-in-possession. As authority she cites *Kremen v. Harford Mut. Ins. Co. (In J.T.R. Corp.)*, 958 F.2d 602 (4th Cir. 1992), where the estate recovered fire proceeds, after the DIP set fire to a bar and grill.

Issue: Does federal law preempt state law, such that the bankruptcy estate cannot be bound by the debtor-in-possession's unauthorized acts.

A. While federal law creates a bankruptcy estate, the right to recover proceeds from an insurance policy is determined from the insurance policy itself.

B. The trustee's interest in the policy is no more or no less than the debtor's interest.

C. Thus, Washington law controls.

D. The court declined to follow Kremen, which the court criticizes for failure to address all of the important nonbankruptcy interests at issue.

Holding: State law, not bankruptcy law, determines contractual terms between the parties, even if one of the parties is in bankruptcy and, thus, the insurer can raise an arson defense against the trustee.

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